

Service Date: April 24, 1995

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

\* \* \* \* \*

IN THE MATTER Of The Application	)	UTILITY DIVISION
Of The MONTANA POWER COMPANY For	)	DOCKET NO. 94.8.30
Authority To Increase Rates For	)	ORDER NO. 5800c
Electric Service.	)	(REVENUE REQUIREMENT)

\* \* \* \* \*

**FINAL ORDER**

**APPEARANCES**

**FOR THE APPLICANT:**

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**FOR THE MONTANA CONSUMER COUNSEL:**

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**FOR THE INTERVENORS:**

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**FOR THE COMMISSION:**

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**BEFORE:**

Nancy McCaffree, Chair  
Dave Fisher, Vice Chair  
Bob Anderson, Commissioner  
Danny Oberg, Commissioner  
Bob Rowe, Commissioner

**FINDINGS OF FACT**

**BACKGROUND**

1. On August 22, 1994, the Montana Public Service Commission (Commission) received an application from the Montana Power Company (MPC or Company) for authority to increase electric rates. At the time of the application MPC sought to raise electric rates to recover an additional \$30,591,053 in annual revenues. The filing represented a uniform percentage increase of 9.31 percent in base rates for all Montana jurisdictional electric customers. MPC's application did not contain allocated cost-of-service studies nor proposed adjustments to its electric and natural gas structures.

2. Concurrent with its general rate increase application, MPC requested an interim increase in electric rates of \$16,728,883.

3. On August 25, 1994, the Commission issued Protective Order No. 5800.

4. On August 30, 1994, the Commission issued a Notice of Application and Intervention Deadline and Procedural Order No. 5800a. The Commission established a procedural schedule setting March 7, 1995, as the opening day of the hearing.

5. On September 21, 1994, the Commission staff granted intervention in this Docket to the following:

Montana Consumer Counsel  
Large Customer Group  
Colstrip Energy Limited Partnership  
District XI Human Resource Council

6. On October 5, 1994, the Commission issued a Notice of Commission Action which granted late intervention in this Docket to the Department of Natural Resources and Conservation (DNRC).

7. On October 14, 1994, the Commission issued a Notice of Commission Action which granted late intervention in this Docket to the Federal Executive Agencies, Malmstrom Air Force Base.

8. On November 21, 1994, MCC filed its response testimony in this Docket. That testimony recommended an increase in jurisdictional annual electric revenues of \$2,276,367.

9. On November 28, 1994, the Commission issued Interim Order No. 5800b which authorized MPC an interim increase in annual Montana jurisdictional electric revenues of \$7,642,367. That order was approved by a vote of 3 - 2. Commissioners McCaffree and Rowe voted no. Commissioner Rowe attached a written dissent.

10. On January 17, 1994, MPC filed rebuttal testimony in this Docket. The Company's rebuttal testimony reduced the amount requested to \$24,651,012, a decrease of \$5,940,041 from the original filing. The rebuttal filing represented a uniform percentage increase of 7.4 percent in base rates for all Montana jurisdictional electric customers.

11. On February 7, 1995, the Commission issued a Notice of Public Hearing scheduling the hearing for March 7, 1995, and stating that separate "satellite hearings" may be scheduled at a later date.

12. On February 24, 1994, MCC filed a Motion to Suspend the Procedural Schedule or in the Alternative to Reserve the Coal Expense Issue. MCC gave the following reason for its Motion:

Because Senate Bill 284, changing the standard for evaluation of the reasonableness of a utility's cost of coal purchased from an affiliate, is likely to be enacted before the Commission issues a final order in this case, the Montana Consumer Counsel (MCC) moves that the Commission suspend the procedural schedule, or in the alternative, that it reserve the coal expense issue for hearing at a later date.

13. On February 28, 1995, MPC filed its response to MCC's Motion. MPC agreed that if Senate Bill 284 is enacted, additional testimony will be required to address the new standard for evaluation of the reasonableness of MPC's coal costs. Therefore, MPC agreed that the coal issue should be reserved for hearing at a later date

following new testimony on the issue. MPC further agreed that it would file a new affirmative case under the Senate Bill 284 standard.

MPC did not agree that the entire case should be continued and urged the Commission not to continue the entire case.

14. On March 1, 1995, MCC filed a reply to MPC's response to the MCC Motion to Suspend the Procedural Schedule. MCC pointed out that their witness had included a 25 basis point addition to MPC's cost of equity based on MPC's "somewhat higher risk" relative to the industry.

Those risks were based on many factors, including regulatory treatment. Rather than prejudging cost of capital issues, MCC asked the Commission to postpone the hearing in its entirety.

15. On March 2, 1995, at a duly noticed work session, the Commission denied MCC's Motion to Suspend the Procedural Schedule, but granted its request to reserve the coal cost issue for discovery, testimony and a later hearing date. The Commission reserved the right to address the need for further proceedings on the issue of cost of capital after the hearing on the rate increase application.

16. On March 6, 1995, the Commission, at the request of the parties, agreed to delay the start of the hearing until March 8, 1995, at which time the Commission held the hearing in this Docket. The hearing began at 9:00 with the introduction of three stipulations. According to MPC the stipulations resolved all remaining contested issues in this Docket.

#### **MPC/MCC Stipulation**

17. The first stipulation was between MPC and MCC. A copy of that stipulation is attached to this Order as Attachment A. MPC and MCC entered into negotiations regarding potential settlement of the case and reached a negotiated settlement resolving all issues raised by MPC in its filing, including the coal expense issue.

18. MPC and MCC agreed to the following:

1. A final increase of \$13,860,749 in total jurisdictional revenue requirement, an increase of \$6,218,167 over Interim Order No. 5800b.

2. Deferral of costs associated with environmental mitigation in the relicensing of the Kerr Dam pursuant to an Accounting Order.
3. Stipulated rates effective for services rendered on and after May 1, 1995.
4. Stipulated rate increase incorporating a five-year amortization of the settlements reached with the Bonneville Power Administration (BPA) and Western Area Power Administration in the amount of \$7,254,827, the total electric utility number.
5. Settlement of issues related to demand-side management (DSM) investments and hydro capabilities addressed in separate stipulations.

MPC and MCC entered into this stipulation in settlement of all issues raised by MPC in its application.

#### **DSM Stipulation**

19. The second stipulation was among MPC, MCC and District XI Human Resource Council (HRC), attached to this Order as Attachment B. Summary of the parties' agreements in the stipulation follows:

#### **Program Cost Recovery**

1. MPC has, to date, acted prudently in its design and implementation of DSM programs, which were designed to be generally consistent with MPC's Integrated Resource Plan (IRP).
2. DSM programs should be evaluated individually and the results of these individual program evaluations should be considered when determining rate treatment.
3. MPC's DSM programs in this test year (\$8,296,167) are appropriate for inclusion in its cost of service for ratemaking purposes.

#### **Benefit/Cost (B/C) Tests**

1. Traditional cost effectiveness tests are indicators of relative costs and benefits from different perspectives. The parties also acknowledge that societal costs, while difficult to measure, deserve consideration.
2. No one B/C test should be used as an absolute determinant for rate treatment.

3. A B/C calculation should be performed using the best available information on the performance of MPC's DSM programs and the economic test that best characterizes the ratepayer's perspective is the Utility Cost Test (UCT).

The traditional UCT compares the quantifiable economic benefits of a DSM program (avoided cost value) to the program costs incurred during that time period. To be consistent with Montana's IRP guidelines, environmental externalities should also be included. Therefore, the B/C calculation should also account for the value of avoided environmental externalities in the IRP process. In future proceedings, when an individual DSM program UCT B/C is less than 1.0, MPC shall make an attempt to both qualify and quantify a broader set of societal benefits and costs. MPC shall also provide testimony addressing whether it is appropriate to include these values in justifying a program's modification or continuation.

The Commission has prescribed a 15 percent cost-effectiveness advantage for marginal DSM measures, which is recognized in the IRP guidelines. However, this adjustment is specifically intended to be applied in the static screening of marginal DSM measures, and should not be applied as an adder to the total value of a DSM program.

4. The DSM programs evaluated in this proceeding were selected by MPC's IRP and passed a Total Resource Cost (TRC) Test at the time they were selected.
5. A participating customer receives a unique set of benefits from DSM investments. It is this full set of benefits against which the customer weighs his/her contribution. Many of these benefits are not easily quantifiable in dollar terms (such as increased comfort). Therefore, measurement of customer satisfaction, combined with effective complaint resolution, is the best means of determining whether the customer's expectations have been met.

All program-related costs not clearly associated with non-DSM objectives should be considered in the development of the B/C ratio, whether or not they can be shown to have contributed directly to the level of energy savings.

#### **Avoided Costs**

1. The default tariff avoided costs do not totally represent the costs avoided as a result of DSM investments. In many cases, DSM investments may defer or avoid the need to upgrade or replace transmission and distribution (T&D) facilities. This value is not reflected in the default tariff.
2. Until an appropriate method can be developed which addresses the average contribution of DSM savings to reductions in T&D investments, MPC should continue to use the default tariffs as an indication of the approximate value of DSM investments. Exception to this rule should be considered when specific T&D savings can be attributed to a specific program or project.

#### **Evaluation Methodology**

1. The Statistically Adjusted Engineering Method of performing ex post DSM program evaluation is generally accepted and used extensively across the country for this purpose.
2. There are trade-offs between the cost of performing program evaluations and the accuracy of their results.
3. For the purposes of this stipulation, sampling techniques, data cleansing activities, engineering methodologies, surveying tools, etc., used by RCG in their evaluations of MPC's programs provide reasonable approximations of the costs, benefits, and efficiencies of MPC's programs, for a reasonable cost.
4. The methodology used to evaluate DSM programs should attempt to characterize all relevant costs and benefits. However, some of these values are difficult to quantify. Therefore, it is especially important to critically examine whether broader societal costs and benefits can justify continuing a program when its UTC B/C is less than 1.0.

#### **General**

1. MPC has designed and is implementing a set of DSM programs intended to capture cost-effective DSM resources.
2. The cost-effectiveness of DSM programs vary over their respective life-cycles. An evaluation of a program's performance at a specific point in time may not be representative of its overall cost-effectiveness.

3. MPC has established a well-defined process by which DSM is planned, designed, implemented and evaluated. Each part of the process allows MPC to adjust the direction and magnitude of its DSM activities in a timely manner.
4. MPC has appropriately evaluated the performance of its programs and is taking actions to address issues identified through that evaluation.
5. MPC should continue to evaluate all DSM programs in a timely manner. The results of those evaluations should be distributed to the Commission and MPC's Conservation and Least Cost Planning Advisory Committee.
6. This stipulation does not relieve MPC from its traditional ratemaking responsibilities with respect to its DSM expenditures.

#### **Hydro Resource Capability Stipulation**

20. The third stipulation (Attachment C) was entered into between MPC, MCC, and DNRC on MPC's Hydro Resource Capability. The Large Customer Group did not address this issue in this Docket, but stated that it has no objection to this further stipulation agreement.

The parties stipulated that the "Stipulation Agreement Concerning the Montana Power Company's Hydro Resources Capability, "entered into in Docket No. 93.7.29, is binding upon the signatory parties in Docket No. 94.8.30.

#### **Commission Decision - MPC/MCC Stipulation**

21. The stipulation between MPC and MCC finds appropriate a jurisdictional revenue increase of \$13,860,749. In analyzing the stipulation, the Commission assumed that adjustments made in the Interim Order in this Docket would be continued in the stipulation. Two major issues remain, the cost of capital, specifically the return on equity, and the coal issue. The Commission looked at a range of indicators on interest rates and rates of return authorized by other commissions around the country. The Commission found that interest rates had increased since Docket No. 93.6.24.

22. There is no delineation of issues by the parties in the stipulation. Any attempt to assign values to specific issues such as rate of return and coal expense is speculative. As a check on the reasonableness of the stipulation, the Commission examined several potential rate of return numbers and several coal expense variations.

The coal expense variations include many unanswered questions because of the passage of SB 284, as well as the post SB 284 final arbitration of the coal prices for Colstrip Units 1 and 2. By itself, the Arbitration Order results in a reduction of MPC's coal expense purchases from Units 1 and 2 of about \$1.7 million. Whether the Colstrip 3 unit price per ton would be affected in ratemaking is an unanswered question; however, its price is 20 percent higher than the pre-arbitration price of Colstrip 1 and 2 coal. Neither party to the stipulation asked the Commission to hold in abeyance its consideration of the stipulation so as to consider the impact of the Colstrip 1 and 2 arbitration. Worthy of note on this point is MPC's stated intention to file, before September 30, 1995, another case in which this issue may be considered.

23. After considering the alternatives and MPC's intention to file an application before September 30, 1995, the Commission concludes that the revenue requirement contained in the stipulation falls in the range of reasonableness. The Commission will examine MPC's coal costs, consistent with the methodology passed into law in SB 284, in the next rate case. The Commission may also conduct additional discovery on a recent arbitrator's decision or pursue other courses of action if MPC does not file a 1995 rate case.

#### **Commission Decision - DSM Stipulation**

24. The Commission finds that the stipulation reached by MPC, MCC and HRC reasonably addresses the issues related to MPC's request to rate base \$8,296,167 in DSM investments during the test year. The Commission finds that MPC's test year DSM expenditures may be recovered through rates. However, the stipulation purports to define the basic terms and conditions governing consideration of ex post evaluations of DSM programs. The Commission finds that these terms

and conditions are reasonable insofar as the settlement of this case is concerned. The Commission does not, and the Company should not, embrace them as Commission policy for any ex post evaluation that may be presented in future filings. This finding results from the fact that the technical hearing in this case was continued following presentation of the stipulation. Expert witnesses familiar with the ex post evaluations were not available for cross examination. Therefore, the Commission may not have complete information on all the ex post evaluation findings included in the stipulation.

25. Nevertheless, the Commission finds certain of the stipulation's findings noteworthy. DSM programs should be evaluated individually. Due to unquantifiable costs and benefits, or inaccurate estimates of costs and benefits, cost-effectiveness tests represent relative costs and benefits from different perspectives. No single cost effectiveness test should be used as an absolute measure of a program's performance. Default tariff avoided costs do not fully represent the costs that are avoided through acquisition of DSM.

26. MPC should continue to submit results of DSM program evaluations to the Commission and should work to enhance the quality of evaluations where possible.

**Commission Decision - Hydro Resource Capability Stipulation**

27. The Commission adopts the stipulation between MPC, MCC and the Department of Natural Resources and Conservation. The stipulation concerning MPC's hydroelectric resource capability entered into in Docket No. 93.7.29 is binding on the signatory parties in this case.

**Accounting Order for Kerr Dam Mitigation Costs**

28. The stipulation between MPC and MCC requested issuance of an accounting order similar to that MPC presented to the Commission with its application, which would allow MPC to defer costs associated with environmental mitigation in the relicensing of the Kerr Dam. This Order grants MPC the authority to defer costs associated with environmental mitigation for Kerr Dam. MPC may defer such costs for a period not to exceed two years. MPC's current estimate of the one-time cost of Kerr Mitigation is \$32,568,320 (Source: MPC Late Filed Exhibit No. 1). The authority to defer costs is limited to that amount. Amounts deferred pursuant to this Order must be amortized over the entire remaining life of the Kerr Dam license which runs through the year 2035. The amortization must occur ratably over the life of the license. Costs associated with the purchase of replacement power shall not be deferred pursuant to this Order. Exclusion of the purchased power expenses is consistent with the testimony of Mr. Gannon at the hearing. The authority to defer these costs in no way guarantees the recovery of any of these costs in future rates. MPC maintains the burden of proof for these expenses.

#### **PSC Tax**

29. In Docket No. 94.8.36, Order No. 5801, the effective PSC tax rate was reduced from .28 percent to .23 percent. MPC has accrued this decrease for the seven months beginning November 1, 1994, through April 30, 1995. The Commission finds that MPC shall amortize the accrued reduction over the five (5) months preceding the next PSC tax change which occurs October 1, 1995. Therefore, the amortization shall occur for the period beginning May 1, 1995, through October 1, 1995.

#### **CONCLUSIONS OF LAW**

1. Applicant, Montana Power Company, furnishes electric and gas service for consumers in the State of Montana, and is a public utility under regulatory jurisdiction of the Montana Public Service Commission. Section 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rates and operations. Section 69-3-102, MCA, and Title 69, Chapter 3, Part 3, MCA.

3. The Montana Public Service Commission has provided adequate public notice of all proceedings and an opportunity to be heard to all interested parties in this Docket. Sections 69-3-303, 69-3-104, MCA, and Title 2, Chapter 4, MCA.

4. The rate level approved herein is just, reasonable, and not unjustly discriminatory. Sections 69-3-330 and 69-3-201, MCA.

#### **ORDER**

THE MONTANA PUBLIC SERVICE COMMISSION HEREBY ORDERS:

1. Applicant, Montana Power Company, is hereby authorized an increase in annual Montana jurisdictional electric revenues of \$13,860,749 in lieu of and not in addition to Interim Order No. 5800b.

2. Montana Power Company is hereby authorized to implement increased rates, beginning on the effective date of this Order, designed to increase annual Montana jurisdictional electric revenues by \$13,860,749. The increased rates shall be on a uniform percentage basis.

3. Applicant is hereby ordered to comply with all directives of the Commission as described in the body of this Order.

4. For the purposes of calculating interim relief in MPC's next general rate filing, the Commission finds that a return on equity of 11 percent granted in Docket No. 93.6.24, Order No. 5709d, shall be used.

5. The effective date of this Order is May 1, 1995.

DONE AND DATED this 21st day of April, 1995, by a 4 to 1 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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NANCY McCAFFREE, Chair

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DAVE FISHER, Vice Chair

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BOB ANDERSON, Commissioner

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DANNY OBERG, Commissioner

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BOB ROWE, Commissioner  
(VOTING TO DISSENT, WRITTEN DISSENT ATTACHED)

ATTEST:

Kathlene M. Anderson  
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

## TABLE OF CONTENTS

APPEARANCES .....	2
FINDINGS .....	3
BACKGROUND .....	3
MPC/MCC Stipulation .....	5
DSM Stipulation .....	6
Program Cost Recovery .....	6
Benefit/Cost (B/C) Tests .....	6
Avoided Costs .....	7
Evaluation Methodology .....	8
General .....	8
Hydro Resource Capability Stipulation .....	9
Commission Decision - MPC/MCC Stipulation .....	9
Commission Decision - DSM Stipulation .....	10
Commission Decision - Hydro Resource Capability Stipulation .....	11
Accounting Order for Kerr Dam Mitigation Costs .....	11
PSC Tax .....	11
CONCLUSIONS OF LAW .....	12
ORDER .....	12

**DISSENT OF COMMISSIONER ROWE**

**Docket No. 94.8.30**

**Order No. 5800c**

I reluctantly dissent from the Commission's decision to approve the revenue requirement stipulation in this case. The stipulation adopts an overall revenue increase, but does not attribute the amount of that increase to specific elements. However, it is clearly based on assumptions about return on equity and coal prices which I am unable to accept based on the record in this case as it now stands. While disagreeing with the result, I have the highest respect for the care with which each commissioner made her or his decision.

The Order approved by the Commission does include some important provisions concerning future MPC filings. I do not oppose approval of the DSM evaluation stipulation or of the hydro capability stipulation. I also do not oppose five year amortization of the BPA and WAPA settlements.

Stipulations are important and valuable tools, both in resolving specific issues and in settling entire cases. However, where a stipulation proposes to fully resolve a general rate case or other matter of general public concern, it is especially important that the Commission make a reasoned decision based on a complete record.<sup>1</sup>

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<sup>1</sup> The Model Settlement Guidelines, prepared by the NARUC Staff Subcommittee on Administrative Law Judges includes the following relevant provisions:

**IV. Confidentiality of Settlement Proceedings.**

- B. In hearings on full or partial settlements or in which a settlement is contested, independent proof of facts in issue between the parties is required and may not be established by reference to information provided or obtained through the settlement process.

**VI. Presentation of Settlements.**

- B. A settlement in a general rate case or other proceeding involving the public at large, or significant segments of a utility's customers, should only be accepted after a public hearing on the settlement, which includes the stipulation into evidence of all prefiled testimony and exhibits. Additionally there must be adequate independent evidence presented by the parties in support of the settlement to allow the hearing officer to make a reasoned decision on the benefits and

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shortcomings of the settlement. A party contesting part or all of the settlement must affirmatively do so through the presentation of an evidentiary case, legal arguments or written comments regarding the settlement.

Such an evaluation is especially difficult in this case. At the parties' request the stipulation was presented in lieu of a full hearing. Only one witness was sworn in. At my request, other pre-filed testimony was offered into the record, but no examination occurred. There was no testimony concerning the effect of Senate Bill 284, requiring a "comparable contract" methodology for coal purchased from electric utility affiliates. Senate Bill 284 had passed second reading several days earlier but had not yet been signed into law.

Evaluating the reasonableness of this stipulation involves four basic assumptions: (1) The interim order was based on carrying forward the basic methodology of the last general rate case (and with the following three changes, these decisions are also carried forward to the final order); (2) Amortization of the BPA and WAPA settlements was at the level stated; (3) The final order implicitly contains a higher return on equity than that authorized in the interim; and (4) The parties agreed to a lower disallowance for "captive coal" purchased by MPC from its wholly-owned affiliate.

The \$6.2 million difference between the interim increase and the stipulated final increase is largely driven by changes in the return on equity and the amount of the coal disallowance. To find the stipulated amount reasonable, some combination of an increase in the return on equity and a decrease in the coal disallowance must be found reasonable. The higher a return on equity which is accepted, the smaller the decrease in the coal disallowance which must be found reasonable.

In the last MPC rate case, I reviewed the return on equity issue and concluded that 10.5 percent was reasonable. (The Commission voted 3-2 to approve an 11 percent return, substantially above the high end of the Montana Consumer Counsel's recommended reasonable range.) Evidence in this case supports a higher return on equity than was appropriate in the last case. However, without fully considering the case, it is difficult to say how much higher. The parties essentially increased their

proposals .5 percent from the last case. For purposes of evaluating the settlement, I will assume a similar increase, to 11.0 percent, which basically brings my revenue requirement figure to the level of the interim increase in this case.<sup>2</sup>

The foregoing makes careful evaluation of the coal issue critical. Without accepting an even greater increase in the return on equity (which I am unwilling to do without benefit of a full hearing), determining that the stipulation produces a reasonable result requires assuming that the entire amount MPC requested for its coal is reasonable.

On March 2, several days before the hearing was set to commence, the Commission approved MCC's request to separate out the coal issue, taking additional testimony on application of Senate Bill 284, which requires the Commission to use a "comparable contract" methodology to evaluate affiliate coal purchases. (On March 2 it was clear both that the law would change and how it would change.) The Commission denied MCC's motion to continue other parts of the hearing. I continue to believe this was the correct approach.

At this time, the Commission has no testimony concerning application of the "comparable contract" methodology, and has heard no direct or cross examination on the issue. Under the procedure adopted March 2, this evidence would have been developed. Such evidence is required both because the law changed shortly before this matter was to go to hearing, and because of factual developments which may be relevant to application of the new methodology.<sup>3</sup>

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<sup>2</sup> One basis point equals about \$70,000. An 0.5 percent change in the rate of return equals about \$3.5 million.

<sup>3</sup> On March 17, 1995, a three-member arbitration panel resolved a coal price dispute between MPC's WECO affiliate and Puget Sound Power and Light, one of the other Colstrip partners. The arbitration applied to Colstrip Units 1 and 2 and was retroactive to 1991. It produced a substantially lower coal price than had been charged by MPC-WECO.

Comparing the price produced by the arbitration order with the price MPC proposes in this case would involve a number of questions, including possibly differing treatment of reclamation expenses, whether the Colstrip 1 and 2 price is directly comparable to the overall Colstrip price, and - most importantly - whether this information is relevant to the

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"comparable contract" comparison. Continuing with the March 2 procedure would have allowed these and other relevant issues to be addressed. It must be noted that at this time the record contains no evidence concerning the arbitration order.

For the reasons stated, I do not believe approving the stipulation is appropriate.  
Therefore I dissent.

RESPECTFULLY SUBMITTED this 21st day of April, 1995.

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BOB ROWE